

Before the
MAHARASHTRA ELECTRICITY REGULATORY COMMISSION
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CASE No. 152 of 2016

In the matter of

**Petition of Maharashtra Electricity Distribution Co. Ltd. for amending the Multi-Year
Tariff Regulations, 2015 with regard to the provisioning for Bad and Doubtful Debts**

Coram

Shri. Azeez M. Khan, Member
Shri. Deepak Lad, Member

Maharashtra State Electricity Distribution Co. Ltd.

Petitioner

Appearance

For the Petitioner:

Smt. Deepa Chawan (Adv.)

Consumer Representatives:

Shri. Ashish Chandaran (VIA)
Shri. Sarang Sontakke (CMIA)
Dr. Ashok Pendse (TBIA)

ORDER

Dated: 10 January, 2018

1. The Maharashtra State Electricity Distribution Co. Ltd. (MSEDCL) has filed a Petition on 11 November, 2016 for amendment of Regulation 82 of the MERC (Multi Year Tariff Regulations) ('MYT Regulations'), 2015 relating to the provision for bad and doubtful debts.

2. MSEDCL's substantive prayer is as follows:

"...c) To link the Bad debts to revenue and 1.5% of the revenue or more may be provided for provision for the bad and doubtful debts being Regulation 82 of the MERC (Multi Year Tariff) Regulations 2015;..."

3. The Petition states as follows:

- 3.1. MSEDCL seeks amendment of Regulation 82 of the MYT Regulations, 2015 relating to the provision for bad and doubtful debts, which was notified without considering the comments/suggestions submitted by MSEDCL vide its letter dated 30.09.2015 before the finalization of the Regulations.
- 3.2. 'Bad debts' usually refer to accounts receivable (or trade accounts receivable) that will not be collected. The provision for doubtful debts is the estimated amount of bad debts that will arise from accounts receivable but not yet collected. It is identical to the allowance for doubtful accounts. The provision is applied under accrual basis accounting, so that an expense is recognized for probable bad debts in the same accounting year so as to have a clear picture of expenses and losses during the same period. Thus, the net impact of the provision for doubtful debts is to accelerate the recognition of bad debts in earlier reporting periods.
- 3.3. Bad debts are inseparable incidences of the business of electricity distribution. Regulation 82 of the MYT Regulations, 2015 provides for provision for bad and doubtful debts for the Supply Business up to 1.5 % of the amount shown as Trade Receivables or Receivables from Sale of Electricity, excluding the provision made for unbilled revenue for bad and doubtful debts.
- 3.4. Changes took place in the treatment of the provision for bad and doubtful debts in the Tariff Regulations over time. Before the MYT Regulations, 2011, the Commission had followed a convention to allow the provision for bad and doubtful debts at 1.5% of the revenue of the corresponding year, and there was no specific provision in the MERC (Terms and Conditions of Tariff) Regulations ('Tariff Regulations'), 2005. Considering the general business practice, provision for bad debts equivalent to a certain percentage of revenue would be more realistic.
- 3.5. Subsequently, the MYT Regulations, 2011 specified that provision for bad and doubtful debts can be made up to 1.5 % of the amount shown as receivables in the audited accounts of the Distribution Licensee, duly allocated for the Wires or Supply Business as the case may be. However, there seems to be no basis for providing 1.5% or linking it to receivables.
- 3.6. Details of actual write-off for previous years are tabulated below:

<u>Provisioning of Bad and Doubtful Debt</u>			Rs. Crs
Financial Year	Provision for Bad Debt	Approved in True Up	Bad Debts Written off
FY 2005-06	204	254	0
FY 2006-07	283	283	0

FY 2007-08	302	302	180
FY 2008-09	352	342	0
FY 2009-10	415	399	0
FY 2010-11	499	477	178
FY 2011-12	593	589	1729
FY 2012-13	684	665	1131
FY 2013-14	353	210	2796
FY 2014-15	301	No True Up Order [258]	399
Total	3986	3521 [3779]	6413

It will be seen from the above Table that the amount of provision to be made as per the Regulations is much less than the actual amount of bad debts written off. The primary reason for the lower approval is insufficient regulatory provision for bad debts.

3.7. The arrears from agriculture consumers constitute around 50% of the total arrears of MSEDCL. By and large, the capacity of agriculture consumers to pay electricity bills is less. In case of natural calamities such as drought, flood, fire, etc. and debts burden, the arrears amount increases and the possibility of recovering it is remote. Thus, considering the past trend and high uncertainty of realization of revenue, the provision for bad debts needs to be increased.

3.8. The current provision for bad debts for FY 13-14 and FY 14-15 will financially affect MSEDCL significantly. MSEDCL is passing through a precarious financial situation and this provision will worsen its already depleted financial position. A comparison of the provision for bad debts as per previous practice and present regulatory provision is as shown below.

(Rs. Crore)

<u>Financial Year</u>	<u>Revenue</u>	<u>Receivables excl GOM Subsidy (Including unbilled revenue)</u>	<u>Provision for Bad debts (1.5% of Revenue) (Old)</u>	<u>Provision for Bad debts (1.5% of Receivables) (New)</u>	<u>Difference</u>
FY 13-14	50,961	21,219	764	318	446
FY 14-15	55,135	22,533	827	338	489

3.9. The provision for bad debts generally depends on the nature of the business and the risk involved. Considering the very nature of bad debts, it may not be appropriate to put a ceiling on the provision for the bad debts. The following Table shows the provision for bad debts in the Tariff Regulations of other State Electricity Regulatory Commissions (SERCs) in the country.

<u>Sr. No.</u>	<u>State</u>	<u>Provision for Bad Debt</u>
1.	GUJARAT	

<u>Sr. No.</u>	<u>State</u>	<u>Provision for Bad Debt</u>
	<p><i>As per Gujarat Electricity Regulatory Commission (Multi Year Tariff) Regulations, 2011</i></p> <p><i>As per Gujarat Electricity Regulatory Commission (Multi-Year Tariff) Regulations, 2016</i></p>	<p>98.8 Bad debts written off:</p> <p>98.8.1 The Commission may allow bad debts written off as a pass through in the aggregate revenue requirement, subject to prudence check.</p> <p>94.9 Bad debts written off:</p> <p>94.9.1 The Commission may allow bad debts written off as a pass through in the Aggregate Revenue Requirement, based on the trend of write off of bad debts in the previous years, subject to prudence check: Provided that the Commission shall true up the bad debts written off in the Aggregate Revenue Requirement, based on the actual write off of bad debts excluding DPC waived off, if any, during the year, subject to prudence check: Provided further that if subsequent to the write off of a particular bad debt, revenue is realised from such bad debt, the same shall be included as an uncontrollable item under the Non-Tariff Income of the year in which such revenue is realized.</p>
2.	<p><i>MADHYA PRADESH MPERC (Terms and Conditions for Determination of Tariff for Supply and Wheeling of Electricity and Methods and Principles for Fixation of Charges) Regulations 2015 [2015(RG-35(III) of 2015]</i></p>	<p>35 Bad and Doubtful Debts</p> <p>Bad and Doubtful Debts in the ARR shall be allowed based on actually written off bad debts in the past as per the available latest audited financial statements to the extent Commission considers it appropriate and shall be trued up during the true up exercise for the relevant year subject to a maximum limit of 1% of the yearly <u>revenue</u>.</p>
3.	<p><i>CHATTISGARH CSERC MYT Regulations, 2015</i></p>	<p>66.8 A provision of maximum 1% revenue of retail supply business shall be allowed. The same shall be subject to true up on aggregate basis at the end of control period on actual basis and prudence check made by the Commission.</p>
4.	<p><i>Kerala Kerala State Electricity Regulatory Commission (Terms and Conditions</i></p>	<p>83.Provision for bad debts. – (1) The Commission may allow a provision for bad and doubtful debts in the revenue requirement of the distribution business/licensee, based on past data</p>

<u>Sr. No.</u>	<u>State</u>	<u>Provision for Bad Debt</u>
	<i>for Determination of Tariff) Regulations, 2014</i>	
5.	<i>Bihar Bihar Electricity Regulatory Commission (Multi Year Distribution Tariff) Regulations, 2015</i>	28. Bad and Doubtful Debts: Bad and Doubtful Debts shall be allowed as a legitimate business expense provided the distribution licensee actually identifies and writes off bad debts as per the transparent policy approved by the Commission. In case there is any recovery of bad debts already written off, the recovered bad debts will be treated as other income.

3.10. From the above Table, it can be inferred that the bad debts written off can be allowed as a pass through in the Aggregate Revenue Requirement (ARR), subject to prudence check. Further, the ceiling is linked to revenue and not the receivables. Therefore, the Commission may link the Bad debts to revenue and not to receivables, as was the case before the MYT Regulations, 2011.

4. In its response dated 7 January, 2017, the Chamber of Marathwada Industries and Agriculture (CMIA), an Authorised Consumer Representative, has stated that:

4.1. MSEDCL has highlighted the Tariff Regulations of five SERCs, viz. Gujarat, Madhya Pradesh, Chhattisgarh, Kerala and Bihar, in support of its request for changing the provision for bad debts in the Commission's MYT Regulations. The provision for Bad Debts allowed by these SERCs for the period FY 2010-11 to FY 2014-15 is as given below:

(Rs. Crore)

Details	FY 10-11		FY 11-12		FY 12-13		FY 13-14		FY 14-15	
	P.B. D	ARR	P.B. D	ARR	P.B. D	ARR	P.B. D	ARR	P.B. D	ARR
MSEDCL	477	31767	589	39221	665	44319	210	49078	258	55028
Gujarat	12.71	21797	23.54	25863	6.60	29459	7.80	31892	9.95	37428
Madhya Pradesh	-	10255	-	12151	3.00	15367	3.00	20015	6.00	21046
Chhattisgarh	36	4261	Nil	6077	15.96	6790	Nil	7629	Nil	9031
Kerala	-	-	-	-	-	-	Nil	9546	5.00	9766
Bihar	Nil	3099	Nil	4048	Nil	4270	Nil	5217	Nil	6424

4.2. The provision for Bad debts approved above as a percentage of ARR is as tabulated below:

<u>Details</u>	<u>FY 10-11</u>	<u>FY 11-12</u>	<u>FY 12-13</u>	<u>FY 13-14</u>	<u>FY 14-15</u>
MSEDCL	1.50%	1.50%	1.50%	0.43%	0.47%
Gujarat	0.06%	0.09%	0.02%	0.02%	0.03%
Madhya Pradesh	0.00%	0.00%	0.02%	0.01%	0.03%
Chhattisgarh	0.84%	0.00%	0.24%	0.00%	0.00%
Kerala	-	-	-	0.00%	0.05%
Bihar	0.00%	0.00%	0.00%	0.00%	0.00%

- 4.3. From the above Table, it is evident that MSEDCL is enjoying the highest provision for Bad debts even after the amendment in the MYT Regulations from 2011 allowing 1.50% of Bad Debts on receivables instead of revenue.
- 4.4. States like Andhra Pradesh, Telangana, Karnataka, Delhi, Haryana, Himachal Pradesh, Jharkhand, Uttar Pradesh, West Bengal and Punjab are not allowing provision for Bad Debts in the ARR.
- 4.5. MSEDCL has cited case law relating to writing off bad debts and Non-Performing Assets (NPAs) of the Banks. Before writing off bad debts, Banks have to follow the procedure for recovery of loans by attaching primary and collateral securities in addition to the properties of the Personal Guarantors, etc. After making these efforts, Banks auction NPAs to Restructuring Companies. If there is any balance, they write off the unrecoverable portion of bad debts from their profits. They maintain all records of their efforts for recovery of bad debts. Moreover, Bank officials responsible for sanction of loans are made accountable for bad debts.
- 4.6. The Electricity Act (EA), 2003 and other statutory provisions, and Tariff Orders of the SERCs provide protection to the Distribution Licensees for recovery of dues. A Consumer has to provide Security Deposits as per their billing cycles. If the energy bill is not paid by a consumer, the Distribution Licensee has the power to disconnect its energy supply of the consumer. The Licensee can attach property and file a Civil Suit for recovery of dues within the limitation period of 3 years. After exhausting all the remedies, MSEDCL has to write off bad debts of the consumers and then claim for provision for Bad debts.
- 4.7. The other SERCs are strict and not allowing provision for bad debts to Distribution Licensees even after Regulations providing for it.
- 4.8. MSEDCL has written off bad debts of Rs. 6233 crore from FY 2010-11 to FY 2014-15. As per the observation of the Commission in its MYT Order dated 26 June, 2015 in Case No. 121 of 2014, MSEDCL identified all the arrears that in its opinion are not collectible and written them off in its Books of Accounts by taking Board approvals. No record is maintained by MSEDCL on efforts taken to recover Bad

debts of each consumer account and record of recovered written-off bad debts. This practice will not be allowed by the Income Tax Authorities and is not in tune with Standard Accounting Practices. It has not been allowed by any other SERC in India. No officer of MSEDCL is made accountable, as is done in Banks.

4.9. The Auditors have made damaging comments on the procedure followed by MSEDCL in writing off bad debts in its Audited Accounts. Therefore, obviously MSEDCL is not following procedures which are compulsory for writing off bad debts. It defeats the basic objective of allowing provision for Bad debts by the Commission.

4.10. Hence, the Commission may amend the provision for bad debts in the MYT Regulations as follows:

- a. Direct MSEDCL to make a record of bad debts of each consumer with assessment of recoverability position and all the efforts made for recovery of arrears, with accountability fixed on the officer concerned as is done in Banks.
- b. Direct MSEDCL to make separate records of recovered written-off bad debts and add them in the revenue every year.
- c. Direct MSEDCL to conduct a special audit along with the Audited Accounts every year on the records maintained by it for provision for bad debts and recovered written-off bad debts.
- d. Allow provisioning of bad debts after prudence check by taking into account the special Audit Report and confirmation that all efforts of MSEDCL have been exhausted for recovery of dues from consumers.
- e. No other State allows more than 1% of revenue for such provisioning. Many States are not allowing provision for bad debts. Hence, a ceiling may be fixed by taking into consideration the practice in other States.

5. Vidarbha Industries Association (VIA), an Authorised Consumer Representative, vide its letter dated 29 January, 2017, has stated that:

5.1. VIA is opposing MSEDCL's Petition seeking bad debts provision @ 1.5% of the total ARR. Lack of control by the Corporate Office of MSEDCL gives rise to bad debts inspite of the monopolistic nature of electricity distribution in Maharashtra.

5.2. If any consumer needs services or commodities from the same supplier in future also and cannot survive without such commodity and service, the quantum of bad debts in

such business will be almost nil. MSEDCL is enjoying a monopoly in the business of electricity distribution, and hence there is no reason for having bad debts other than the negligence of MSEDCL.

- 5.3. The interest of every Distribution Licensee is statutorily protected by the concept of Security Deposit towards credit extended to the consumers. Once a consumer's arrears crosses the Security Deposit with the Distribution Licensee, immediate effective steps are expected from the Licensee to protect its financial interest. Distribution Licensees are empowered under Section 56 of the EA, 2003 to take such effective steps.
 - 5.4. However, MSEDCL has completely failed in its financial risk management. VIA has pointed out some examples of this in its submission.
 - 5.5. The Commission had earlier observed that the list of receivables of MSEDCL is increasing every year and, therefore, to deal with bad debts, the Commission permitted the provision of 1.5% of bad debts in the ARR. However, MSEDCL did not utilize this provision and it was used to meet shortfalls in cash flow.
 - 5.6. Receivables cannot be treated as bad debts if a creditor is still supplying goods or commodities or services on credit. MSEDCL has utilized these funds to waive the Delayed Payment Charges (DPC) and interest of live consumers in addition to that of Permanently Disconnected (PD) consumers. This is blatant misuse of writing-off receivable as bad debts and still supplying goods on credit.
 - 5.7. The main reason for creation of bad debts is the wrong billing practices at the field level. If MSEDCL undertakes proper risk management, develops software in accordance with the need to monitor risk and takes strong action against defaulting officials, there would be no occasion for creation of bad debts. Even the existing provision for bad debts would not be required if a few effective measures are implemented.
 - 5.8. In these circumstances, the Petition may be dismissed, with directions to MSEDCL to prepare an action plan to recover the PD arrears and report the compliance along with recovery done; and to submit the details of bad debts provision utilized for live consumers and deduct it from the ARR.
6. At the hearing held on 31 January, 2017:
- 6.1. MSEDCL stated that:

- a. Regulation 82 of the MYT Regulations, 2015 allows provision for bad debts upto 1.5% of trade receivables. The Commission may amend this Regulation to allow such provisioning upto 1.5% of total revenue, as in the past.
- b. Earlier, the Commission was allowing 1.5% of revenue as provision for bad debt. This practice was changed to 1.5% of trade receivables through the MYT Regulations, 2011, which was continued in the MYT Regulations, 2015. Although MSEDCL is approaching the Commission for changing the methodology after a lapse of 5-6 years, this delay may be condoned considering the fact that applicability of the MYT Regulations, 2011 was relaxed for MSEDCL for the initial two years and MSEDCL had filed only one Tariff Petition under those Regulations thereafter.
- c. The existing provision for bad debts expects 99.94% collection efficiency, which is not practicable for the electricity distribution business. Therefore, the Commission may revise the provision for bad debts in the MYT Regulations, 2015 based on accounting principles. MSEDCL has submitted details of the practice followed by some other States in this regard.
- d. All the expenses heads in the ARR are factored in on accrual basis, whereas the provision for bad debts is being considered on normative basis. The Appellate Tribunal for Electricity (APTEL) has ruled that all expense heads need to be treated uniformly. The Commission may devise the methodology for treating the provision for bad debts accordingly.
- e. The MYT Regulations, 2015 also require deduction of unbilled revenue from trade receivables before calculating the allowable amount towards provision for bad debt. This is creating inconsistency as unbilled revenue is considered as part of income, but is not considered while calculating the provision towards bad debt.

6.2. Shri Ashish Chandarana of VIA stated that:

- a. VIA is opposing MSEDCL's proposal to amend the provision for bad debts to 1.5% of revenue. Though bad debts are an integral part of any business, its quantum depends upon the nature of the business. MSEDCL enjoys a monopoly in the distribution of electricity. No one can live without electricity. Hence, the consumer is always connected with MSEDCL, and this enables MSEDCL to recover arrears from them. Thus, the chances of debts or non-recoverable arrears becoming bad are negligible.
- b. Earlier, the provision for bad debts was being allowed at 1.5% of revenue. However, instead of utilizing this amount for writing off bad debts, MSEDCL has

utilized it for meeting its working capital requirements. Further, MSEDCL is writing off DPC and penal interest of live consumers from the provision for bad debt, which is not correct.

- c. The EA, 2003 has provided avenues to the Distribution Licensee for protecting its revenue from becoming bad debt. It allows the Distribution Licensee to recover Security Deposit from consumers towards supply of power, and Section 56 allows it to disconnect supply for non-payment of electricity bills. Therefore, if proper risk management is undertaken, its revenue can be protected from becoming bad debt.
- d. VIA has submitted illustrative examples of mismanagement / negligence of MSEDCL which have resulted in increase in consumer arrears. MSEDCL should develop risk management software for monitoring revenue recovery.

6.3. Shri Sarang Sontakke of CMIA stated that its written response dated 27 January, 2017 may be taken on record.

6.4. Dr. Ashok Pendse of Thane-Belapur Industries Association (TBIA), an Authorised Consumer Representative, stated that MSEDCL did not raise this issue of amending the provision for bad debts in its MYT Petition for the earlier 2nd Control Period. MSEDCL should monitor the category-wise and area-wise collection efficiency for identifying any trend which can then be addressed by taking corrective steps.

6.5. In response, MSEDCL stated that it would investigate the illustrative examples submitted by VIA and take corrective actions. MSEDCL would also look into the suggestions made by VIA for reducing and monitoring arrears. MSEDCL requested three weeks for filing its written Reply to the submissions made by the Consumer Representatives. However, the Commission may revisit the provision for bad debts based on accounting principles.

6.6. The Commission directed MSEDCL to submit the following:

- i. Replies to the submissions filed by Consumer Representatives.
- ii. Practices of other SERCs for provision towards bad debts in ARR.
- iii. Accounting principles relating to provision for bad debt.

7. In its submission dated 22 April, 2017 made in pursuance of directions given at the hearing, MSEDCL stated as follows:

7.1. Practice followed by various SERCs with respect to provision for Bad debts are as tabulated below:

<u>State / Regulations</u>	<u>Bad Debts Provision/Practice of SERC</u>	<u>Remarks</u>
<u>Gujarat</u> As per Gujarat Electricity Regulatory Commission (Multi-Year Tariff) Regulations, 2016	94.9 Bad debts written off: 94.9.1 The Commission may allow bad debts written off as a <u>pass through in the Aggregate Revenue Requirement, based on the trend of write off of bad debts in the previous years,</u> subject to prudence check: Provided that the Commission shall true up the bad debts written off in the Aggregate Revenue Requirement, based on the actual write off of bad debts excluding DPC waived off, if any, during the year, subject to prudence check: Provided further that if subsequent to the write off of a particular bad debt, revenue is realised from such bad debt, the same shall be included as an uncontrollable item under the Non-Tariff Income of the year in which such revenue is realized	Bad Debts has been allowed based on actual write off.
<u>Kerala</u> KSERC (Terms and Conditions for Determination of Tariff) Regulations, 2014	83.Provision for bad debts. – (1) The Commission may <u>allow a provision for bad and doubtful debts</u> in the revenue requirement of the distribution business/licensee, <u>based on past data.</u>	Commission allows the provision for Bad Debts based on past data.
<u>Himachal Pradesh</u> Terms and Conditions for Determination of Wheeling Tariff and Retail Supply Tariff Regulations, 2011	Beginning of the control period – business plan filings – In the base year, prior to the filing of multi-year ARR cum Tariff petition, the distribution licensee shall file a business plan approved by its board of directors. The business plan shall be for the entire control period and shall, inter-alia, contain – (h) a set of targets proposed for other items such as collection efficiency, <u>bad debts,</u>	Provision for Bad Debts also considers the investment in Capex.

<u>State / Regulations</u>	<u>Bad Debts Provision/Practice of SERC</u>	<u>Remarks</u>
(Amendment 2013)	working capital, quality of supply targets, etc. The targets shall be consistent with <u>the capital investment plan proposed by the licensee.</u>	
<u>Haryana</u> HERC (Terms and Conditions for Determination of Tariff for Generation, Transmission, Wheeling and Distribution & Retail Supply under Multi Year Tariff Framework) Regulations, 2012	64. Bad and doubtful debts shall be allowed to the extent the distribution licensee has <u>actually written off</u> bad debts subject to a <u>maximum of 0.5% of sales revenue.</u> However this shall be allowed only if the distribution licensee submits all relevant data and information to the satisfaction of the Commission. In case there is any recovery of bad debts already written off, the recovered bad debts will be treated as other income.	Provision for Bad Debts based on % of Revenue linked with actual write off.
<u>Punjab</u> PSERC Terms and Conditions for Determination of Generation, Transmission, Wheeling and Retail Supply Tariff '2014	49.1 Bad and doubtful debts <u>shall be allowed</u> to the extent the distribution licensee has <u>identified/actually written off bad debts,</u> subject to a maximum of <u>1% of annual sales revenue,</u> and according to a transparent policy approved by the Commission. In case, there is any recovery of bad debts already written off, the recovered bad debts will be treated as Other Income.	Provision for Bad Debts based on % of Revenue linked with actual write off.
<u>Madhya Pradesh</u>	35.Bad and Doubtful Debts in the ARR shall be <u>allowed based on actually written off bad debts</u> in the past as per the available latest audited financial statements to the extent Commission considers it appropriate and shall be trued up during the true up exercise for the relevant year subject to a maximum limit of <u>1% of the yearly revenue.</u>	Provision for Bad Debts based on % of Revenue linked with actual write off.
<u>Chhattisgarh</u> CSERC MYT Regulations, 2015	66.8 A provision of maximum <u>1% revenue of retail supply business shall be allowed.</u> The same shall be subject to true up on aggregate basis at the end of control period on <u>actual basis</u> and prudence check made by the Commission.	Provision for Bad Debts based on % of Revenue linked with actual write off.
<u>Bihar</u>	28. Bad and Doubtful Debts: Bad and	

<u>State / Regulations</u>	<u>Bad Debts Provision/Practice of SERC</u>	<u>Remarks</u>
Bihar Electricity Regulatory Commission (Multi Year Distribution Tariff) Regulations, 2015	Doubtful Debts <u>shall be allowed</u> as a legitimate business expense provided the distribution licensee <u>actually</u> identifies and writes off <u>bad debts as per the transparent policy approved by the Commission</u> . In case there is any recovery of bad debts already written off, the recovered bad debts will be treated as other income.	Allows Bad Debts as per actuals.
<u>Uttar Pradesh</u> UPERC (Multi Year Distribution Tariff) Regulations, 2014	29. Bad and Doubtful Debts <u>shall be allowed</u> as a legitimate business expense with the ceiling limit of <u>2% of the revenue receivables</u> provided the distribution licensee <u>actually identifies</u> and writes off bad debts as per the transparent policy approved by the Commission. In case there is any recovery of bad debts already written off, the recovered bad debts will be treated as other income.	Provision for Bad Debts based on % of Revenue linked with actual write off.
<u>Rajasthan</u>	No specific provision for Bad debt. However, Bad Debts has been allowed as per actuals.	Allows Bad Debts as per actuals.
<u>Orissa</u> Order dated 20.3.2013 on MYT principles for 3rd Control Period FY 2013-14 to FY 2017-18	17. The Business Plan order of the Commission dated 20.03.2010 approved collection efficiency of 99% for FY 2011-12 and FY 2012-13. The benchmark of collection efficiency would continue to be at the level of 99% during the third control period also. Accordingly the <u>Bad and Doubtful debts</u> during the third control period would also be allowed <u>@ 1% of the total annual revenue billing in HT and LT sales only</u> .	Provision for Bad Debts based on % of Revenue.

7.2. Every State has its own peculiar circumstances, based on which the respective SERCs make their provisions for bad debts. This Commission has also allowed the practice of treating bad debts as is being sought in this Petition till 2013. Thereafter, the allowance for provision for bad debts has been changed by the Commission, which has resulted in filing of the present Petition.

7.3. The existing provision for bad debts expects 99.91% collection efficiency, which is impractical for the electricity distribution business of a Utility like MSEDCL. Each business model has its own challenges, and provision for accounting Bad debts

should be made looking into such challenges. Electricity distribution is a dynamic business in which the concept of analysis based on receivables would not be prudent. Moreover the practice of accounting for provision for bad debts as 1.5% of revenue has been followed till 2013. Even this had only partly taken care of the aspect of Bad debts. The current provision for bad debts would financially adversely impact MSEDCL, which is already crippled and struggling.

- 7.4. MSEDCL is a Government Company under Section 617 of the erstwhile Companies Act, 1956 read with Section 2(45) of the Companies Act, 2013. It is imperative to consider the treatment provided under the Income Tax Act, 1961 qua the provisions for Bad debts. The Accounts of MSEDCL are maintained as a Government Company under the provisions of the Companies Act and the law governing Income Tax, read with such directions, guidelines and norms as laid down by the Institute of Chartered Accountants of India (ICAI), a statutory body established under an Act of Parliament.
- 7.5. 'Accounting Standard (AS) 9: Revenue Recognition' issued by the ICAI provides for making a separate provision to reflect the uncertainty rather than to adjust the amount of revenue originally recorded. Further, 'AS 8: Accounting Policies, Changes in Accounting Estimates and Errors' provides for estimation of uncertainties inherent in business activities that cannot be measured with precision. Similarly, 'AS 18: Revenue' provides for recognition of bad debts as an expense rather than as an adjustment of the amount of revenue originally recognized.
- 7.6. Hence, accounting principles provide for creation of a separate provision for bad and doubtful debts arising on account of uncertainty of future collection of revenues. Since such uncertainty cannot be measured precisely, it has to be estimated and provided for in the Accounts.
- 7.7. Therefore, there is no rationale for disparity in treating the item head "Bad Debts" in a different and distinct manner. Allowing MSEDCL to write off bad debts in the financial year subject to prudence check would ensure conformity of the regulatory framework with the provisions of the Income Tax Act, 1961.
- 7.8. 25% of the revenue of MSEDCL is from Agriculture, Public Water Works and Street Light categories of consumers which have lower probability of collection for obvious reasons. These categories of consumers are mainly located in the rural areas and their paying capacity is very low. Hence, these categories require provisions for bad and doubtful debts reflecting the actual scenario of lower collection compared to other categories of consumers.

- 7.9. These 3 consumer categories, viz. Agriculture, Street Light and Public Water Works, have a share of 69% in the total arrears as on March 31, 2016. Out of these, the Agriculture category alone has a share of 57% of the total arrears, amounting to Rs. 14,877 crore.
- 7.10. A bad monsoon or poor harvest forces the farmer to ignore other payments such as electricity bills, which makes it difficult for MSEDCL to recover the dues from them. Mounting dues has become a major cause of concern for most Distribution Licensees in India. The recoverable dues from the Agricultural consumers have been increasing.
- 7.11. MSEDCL has from time to time announced schemes and relief in payments for Agricultural consumers, but there has been poor response inspite of mass publicity. Thus, MSEDCL has been making all efforts to recover dues from Agriculture consumers but has been unable to recover them in these circumstances.
- 7.12. On account of these difficulties in recovering arrears from Agricultural and certain other categories of consumers, the Commission may make a realistic provision by way of a higher percentage for bad and doubtful debts.
- 7.13. In rural areas, the collection efficiency has generally been low. Therefore, special attention needs to be given to these areas as the paying capacity of the rural population is very low. Hence, the Commission may consider allowing a higher percentage for bad and doubtful debts in rural areas.
- 7.14. Further, considering the specific problem of NPAs that the Indian banking system is currently facing, the Income Tax Act has allowed a higher provision for bad and doubtful debts of 8.5% as allowable expenditure while computing the taxable income for the purposes of Income Tax. Further, as per Section 36(1)(viii), a deduction of 10% of the aggregate advances made by the rural branches of Banks covered under that Section is allowed for provision for bad and doubtful debts. This additional provision of 10% is being provided for bad and doubtful debts considering the low probability of collection from receivables in respect of advances given to the rural population.
- 7.15. Therefore, the Commission may provide the higher provision for Bad debts of 7% for the consumer categories of Agriculture, Public Water Works and Street Lights.
- 7.16. MSEDCL's response to the suggestions of CMIA is as follows:

- a. MSEDCL welcomes the positive suggestions of CMIA and would work towards their implementation for the betterment of its system. The various hindrances and the steps taken by MSEDCL to overcome them are set out below.
- b. Disconnection Drive: MSEDCL in the last couple of years has made efforts to ensure that the arrears should not increase and be gradually reduced, including drives for disconnection of electricity supply for non-payment.
- c. Theft Detection: MSEDCL has undertaken theft detection drives to ensure that consumers whose power supply has been disconnected for default in payment are not availing power supply in unauthorized ways. Even direct theft of electricity has been curtailed massively through these drives.
- d. Termination of agreement for power supply: In addition to the disconnection drives, MSEDCL has also been terminating agreements for power supply with such defaulting consumers after six months from the date of disconnection and legal action is taken against them by filing recovery suits.
- e. New Amnesty Schemes: MSEDCL has from time to time introduced the following Amnesty schemes to motivate consumers (more particularly Agricultural consumers and Public Water Works) to liquidate their arrears, by providing certain concessions:
 - Krishi Sanjivani Yojna
 - Public Water Supply Sanjivani Yojna
 - Power Loom Sanjivani Yojna
 - Navprakash Yojana
 - Jeevan Sanjivani Yojana
 - Abhay Yojana
- f. However, even after implementing such concessional schemes, if the consumers still do not pay, MSEDCL is left with no option but to write off certain arrears in its books of accounts.

Commission's Analysis and Ruling

8. **Regulation 82 of the MYT Regulations, 2015, which governs the allowable provision for bad and doubtful debts for the Supply Business, reads as follows:**

“82. Provision for Bad and Doubtful Debts—

The Commission may allow a provision for bad and doubtful debts upto 1.5 % of the amount shown as Trade Receivables or Receivables from Sale of Electricity in the audited accounts of the Distribution Licensee for that Year: -

...Provided further that such provision allowed by the Commission for any Year shall not exceed the actual provision for bad and doubtful debts made by the Distribution Licensee in the audited accounts of that Year, duly allocated to the Retail Supply Business, excluding the provision made by the Distribution Licensee for unbilled revenue at the end of the Year:..."

9. **MSEDCL has sought amendment of Regulation 82 of the MYT Regulations, 2015, stating that it had been notified without considering the comments MSEDCL had given on 30 September, 2015 when the Regulations were at the draft stage. The Commission notes that MSEDCL's comments at that time were as follows:**

"4. Provision for Bad and Doubtful debts

4.1 MSEDCL submits that as per the proposed MYT Regulations 2015, a provision for bad and doubtful debts up to 1.5% of the amount shown as Trade Receivables may be allowed by Hon'ble Commission provided that the provision made by the Distribution Licensee for unbilled revenue at the end of the year will not form a part of the Trade Receivables.

4.2 MSEDCL states that unbilled revenue is the revenue which has accrued but which has not been billed to the consumers as on 31st March of the respective year. Such provision of unbilled revenue is necessary since the Accounts of the MSEDCL are being maintained on accrual basis, and is followed every year.

4.3 MSEDCL submits that as per the MSEDCL Audited Account Statements, Receivables include the provision for unbilled revenue also since it is a part of the Revenue which already gets reflected in the Audited Account Statements and Accounting Principles. Therefore, MSEDCL requests the Hon'ble Commission to delete the proviso wherein the provision is made for exclusion of unbilled revenue (3rd Provision of Regulation 72)."

Thus, MSEDCL's suggestion on the draft Regulations was limited to including unbilled revenue in the Trade Receivables against which the percentage for provisioning for bad and doubtful debts is to be applied. However, that issue was already decided by the Commission in its Order dated 29 January, 2016 in Case No. 121 of 2015 (though in the context of the earlier MYT Regulations, 2011 which had a similar provision) as follows:

"54. The main intent of the relevant provisions of the MYT Regulations is to allow inclusion of expenses towards provision for bad and doubtful debts in

the ARR. Such provisioning is utilized for written-off bad debts. Unbilled revenue, though included in 'other Current Assets', cannot be treated as bad or doubtful debts for write-off. Incidentally, in Note-20 of its accounts, where unbilled revenue has been listed along with 'other Current Assets', MSEDCL has not made any provision for doubtful debt, whereas it has been made in Note-15 for Long-term Trade Receivables and Note-17 for Trade Receivables. Thus, there is no merit in MSEDCL's claim for inclusion of unbilled revenue in total Receivables for computation of the provision for bad and doubtful debt."

10. In fact, MSEDCL is now proposing that provisioning for bad and doubtful debts be allowed upto 1.5% of the Revenue instead of the Receivables. The Commission notes, however, that the linking of the allowable provision for bad debts to Receivables instead of to Revenue was not newly introduced by the MYT Regulations, 2015. Admittedly, the previous MYT Regulations, 2011 also allowed provisioning for Bad debts only upto 1.5% of the Receivables, which has not been objected to by MSEDCL till now.
11. MSEDCL has cited the provisions of the Income Tax Act in support of its claim. Those provisions deal with the computation of Income Tax on the profit earned by a person, and allow the provisioning towards bad debts to be deducted from profit for determining the taxable income. However, in the regulated business of Electricity Distribution, the provision for bad and doubtful debts is allowed to be added in the ARR and passed on to consumers through tariffs. Hence, greater diligence and prudence is expected from the Licensee, and also from the Commission with regard to the extent of provisioning to be passed through to consumers.
12. In this context, and with regard to MSEDCL's contention that, inspite of efforts, there are large dues from Agricultural consumers which cannot be recovered and have to be written off, the Commission notes that the tariff of Agriculture consumers is already only 50% of the Average Cost of Supply (ACoS), and is being cross-subsidised by other consumers. The case of Public Water Works and Street Lights is similar; moreover, these are mostly public bodies, many of which have access to State grants. MSEDCL's inability to recover electricity dues from such consumers cannot justify increasing the provision for bad debts and thereby increasing the tariffs of other consumers who are paying their bills. Accepting MSEDCL's contention regarding difficulties in recovery in this manner would also give an undesirable signal to consumers that they need not pay at all.
13. Any business faces some degree of uncertainty in the recovery of its receivables. This is also true of the business of electricity distribution, and hence the Regulations allow some provisioning for Bad debts to be passed on to consumers at

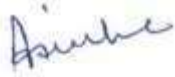
large through tariffs. However, the EA, 2003 also gives Distribution Licensees substantial powers to recover their dues from defaulting consumers. As brought out during these proceedings, better monitoring and prompter action may also improve recovery and reduce arrears.

14. In view of the foregoing, the Commission does not find that any amendment is required in the existing provision for bad and doubtful debts in the MYT Regulations, 2015.

The Petition of Maharashtra State Electricity Distribution Co. Ltd. in Case No. 152 of 2016 stands disposed of accordingly.

**Sd/-
(Deepak Lad)
Member**

**Sd/-
(Azeez M. Khan)
Member**


**(Ashwani Kumar Sinha)
Secretary**

